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Reserve Bank of India

AGRICULTURAL CREDIT DEPARTMENT

STATUTORY REPORT

(Under Section 55 (l) of the
Reserve Bank of India Act)

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STATUTORY REPORT

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STATUTORY REPORT

(Under Section 55(1) of the Reserve Bank of India Act.)

CHAPTER I.

INTRODUCTION.

1. Section 55(1) of the Reserve Bank of India Act prescribes that "the Bank shall, at the earliest practicable date and in any case within three years from the date on which this Chapter comes into force (i.e., on or before the 31st December 1937), make to the Governor General in Council a report, with proposals, if it thinks fit, for legislation, on the following matters, namely:—

Terms of reference.

- (a) the extension of the provisions of this Act relating to scheduled banks to persons and firms, not being scheduled banks, engaged in British India in the business of banking, and
- (b) the improvement of the machinery for dealing with agricultural finance and methods for effecting a closer connection between agricultural enterprise and the operations of the Bank."

2. Part (a) refers to what have come to be known as the indigenous bankers. Their main activities are in connection with the finance of inland trade and small industries in spite of the existence of banks organised on modern lines in the industrial centres of India. To the extent however that they finance the movement of crops and also indirectly provide credit to agriculturists they are an agency for supplying agricultural finance. The question of their improvement and the co-ordination of their activities with

Close connection between them.

the Reserve Bank is thus partly included in part (b) of the terms. The two terms of reference are thus inter-connected.

3. The problem of agricultural credit has received consideration not only in India but every other agricultural country from time immemorial and is one for which no universally applicable solution has yet been found anywhere. The task which has been imposed on the Bank is thus a difficult one and it has not been made easier by the fact that the Bank has been required to undertake this work in the first three years of its existence when it has naturally to devote its energies primarily to evolving its own organization and setting it in motion. From other points of view also the period has not been favourable for an enquiry of this kind. It coincided with the aftermath of a severe depression in agricultural prices throughout the world which has occasioned all sorts of legislative measures in the hope of affording relief to agriculturists. These measures, some of which have been enacted on a professedly emergency basis while others are intended to be of a permanent nature, are of too recent origin to admit of their ultimate effects being gauged with certainty and yet they have introduced new factors which must be taken into consideration.

4. We have, however, from the beginning fully realized that in making these provisions in the Act the legislature was giving expression to the urgency of the problems relating to agricultural credit in India and its keen desire that the Bank should give them its earliest attention. From the outset, therefore, we have given our earnest consideration to this matter and last year we submitted a preliminary report, suggesting such measures as appeared to us necessary in order to make the different agencies engaged in the business of agricultural finance more useful to the agriculturist and at the same time better able to serve as an efficient link between the

money market and the agriculturist. We have also issued two bulletins from the Agricultural Credit Department giving the results of the investigations of that department into various practical aspects of the co-operative movement with suggestions how it might be reconstructed and revitalized. We have also kept in touch with the enactments in the various provinces dealing with agricultural indebtedness and their working. Thus throughout this period we have been busily engaged on this most difficult problem and in this report we summarise the conclusions at which we have provisionally arrived, and which we have to some extent already embodied at greater length in the various publications referred to. As we do not wish to repeat what has already been said in greater detail there this report should be read with reference to them.

CHAPTER II.

VARIOUS AGENCIES FOR AGRICULTURAL CREDIT.

5. In the preliminary report we pointed out the special features of agriculture which distinguish it from industry and commerce and which make it difficult for the ordinary credit agencies to finance it. Apart from the special risks involved in agricultural finance the main difficulty arises from the fact that in India as in several other agricultural countries the majority of the agricultural population consists of small peasant proprietors and tenants with whom agriculture is not so much a profession as a mode of living. The handicap is not merely the lack of substantial assets which could serve as security but also, and possibly to a greater extent, the uncertainty of the profits from agriculture as it is generally carried on. Even in commerce and industry the test of creditworthiness is not so much the value of the fixed assets as their ability to make a profit.

Difficulties of agricultural finance.

If a business does not show a profit and there is little chance of its being made to run profitably no cautious investor will wish to risk his money in it, however highly its buildings, machinery and other fixed assets may be valued. Profit in agriculture as it is carried on in the majority of holdings in India is more often than not a doubtful quantity. This uncertainty instead of leading to thrift and saving results in the creation of a psychology of living for the day so that even when large gains are made in boom times there is a strong temptation to use them up rather than to make provision for the future. Debt comes to be looked upon as an ordinary condition of life and the fundamental principle that borrowings should be utilized for productive and self-liquidating purposes tends to be forgotten. For all these reasons the ordinary sources of credit are not easily accessible to agriculture. The question of agricultural finance is therefore closely linked up with the question of the improvement of agriculture. Before credit can become freely available to the farmer he must be made creditworthy.

6. This consideration has an important bearing on the agency most suitable for supplying finance to agriculture
Essential characteristic of the most suitable agency. in this country. It must have an educative as well as a purely business side. It should supervise the use of credit and see that the farmer employs the money obtained by him in improving the productivity of the land and making the business of agriculture more profitable. An impersonal agency like a loan office which is concerned solely with the profitable investment of its funds cannot serve this purpose and commercial banks generally suffer from the same handicap when dealing with the agriculturist. The credit extended by the tradesman is even more heedless of the benefit to the cultivator. The private moneylender does supply a personal touch but he also is primarily concerned with his own profit. The other great drawback in moneylender's credit is that he tends to charge very high rates of interest, though

farming and the possible dishonesty of the borrower or legislative interference. When Government finances the agriculturist it may be expected to see that what it lends is profitably utilized, but it is inherently not qualified to act as a general financing agency. An agency which satisfies the requisite conditions for agricultural finance is the co-operative society and it has been so recognized in almost all agricultural countries. However short the co-operative movement may have fallen of what was expected from it in India we feel that further effort should be made to render it capable of discharging in the best manner the function of supplying credit to the small agriculturist and we have no hesitation in saying that if credit facilities to the Indian agriculturist are to be improved the co-operative movement must be reconstructed and revitalized so as to serve not only as an effective credit agency but as a motive power for the improvement of agriculture from every point of view.

7. In view of the importance which we attach to the co-operative movement we shall explain our views regarding its improvement in a separate chapter. As
Outline of the report. a special reference has been made to indigenous bankers in the terms of reference we shall also devote one chapter to them. The question of the co-ordination of the various agencies with the Reserve Bank will also be dealt with in a further chapter. First we shall deal briefly with three agencies for supplying agricultural credit viz., (1) commercial banks (2) Government and (3) money-lenders. Other agencies like Loan Offices, Nidhis and Agricultural Banks whose activities are confined to particular provinces will be left out of consideration in this report as we have no proposals to make regarding their co-ordination with the Reserve Bank and the question of their improvement could be discussed separately.

8. With regard to commercial banks we have little to add to what we said in paras 24 to 26 of our preliminary report. We consider that they are in the best position to finance the movement and marketing of crops by making short term advances against produce and in order that they may be able to do so the arrangements for the marketing of crops must be improved by (i) the grading and standardisation of staples and of contracts, (ii) proper storage facilities and (iii) the creation of properly regulated local as well as forward markets. Regulation of markets is necessary by the enactment of special marketing acts which will provide for the licensing of brokers, the conditions of their business, settlement of disputes, use of standard weights and measures, prohibition of illegal deductions, publication of marketing information and construction of warehouses. This subject has been dealt with in great detail by the Royal Commission on Agriculture and further light is being thrown on it by the investigations of the Marketing Department of the Imperial Council of Agricultural Research and we draw the attention of the Provincial Governments to these reports and the desirability of giving effect to their recommendations. Such marketing reform will not only ensure a fairer price to the producer but also encourage commercial banks to take a greater part in financing the sale of agricultural produce. At present in spite of the rapid growth of branch banking it is only in certain parts of Southern India that commercial banks have as yet direct relations even in regard to marketing with the actual producer; in other parts of India their role in agricultural credit is usually that of an intermediary furnishing part of the credit to the indigenous banker and in a small degree to the landlord or the co-operative banks. We consider that there is considerable scope for an increase in the financial support given by commercial banks to moneylenders, indigenous bankers and co-operative banks if they will re-organise themselves on the lines which we are suggesting. Such co-ordination will result in the

strengthening of the credit structure, the benefit of which will ultimately percolate to the tiller of the soil.

9. Government supplies finance to agriculturists through taccavi loans. The smallness of the amount advanced by it when compared with the total finance required by agriculture has been due to the fact that the loans under the Agriculturists Loans Act have mostly been advanced to enable the agriculturists to tide over emergencies and have not been intended to supply his normal finance. As we have already pointed out, we do not think that Government machinery is suited to serve as the source of normal finance to agriculture and Government will remain in its present role of helper in emergencies. Sufficient advantage has also not been taken of loans under the Land Improvement Loans Act and (except in backward areas, the development of which must necessarily devolve to a large extent on Government), we consider that even the finance for the improvement of land can be better supplied by land mortgage banks on business lines where they exist. As the Royal Commission remarked, "What is lacking is not so much capital for land improvement as ideas for utilising it for productive purposes". We feel that what is required from Government is not so much actual loans to cultivators as an active and progressive agricultural policy. The Agricultural Departments of the various Governments should work in the closest possible relation with the co-operative societies and land mortgage banks. Apart from this Government should pursue whole-heartedly a policy which will not only improve the financial position of the agriculturist but improve his life in every way.

10. It is well known that the bulk of agricultural finance is supplied by the moneylender. This term includes professional moneylenders like Banias or other classes who set up regular shops for doing this business, landlords, prosperous agriculturists and

traders; there are also the pawnbrokers, the roving Pathans and others who traffic in moneylending. For a heterogeneous group of this kind it is difficult to generalize. The money-lender undoubtedly serves a necessary function in the village economy and regulation of his business is long overdue. The pendulum now appears to have swung to the other extreme and the various enactments relating to agricultural debts have undoubtedly seriously impaired his activities in many parts of India.

11. It is true that there are innumerable ways of evading debt legislation and that legislation alone will not succeed in improving the methods of the money-lender. It is only natural that money-lenders both good and bad should dislike the new restrictions imposed on them and the impression that recent debt legislation has resulted in a contraction of credit of the agriculturist is probably true. In areas where such legislation is in force it is said that moneylenders have discontinued lending except to old and trusted clients or their own tenants and have restricted their loans to the minimum. But though this has probably caused some hardship to the cultivator it has not been an unmixed evil. It has taught him to try to live within his means and so far there are no complaints of land remaining uncultivated for want of finance. The legislation for regulating moneylending must not, however, be judged by this temporary result. Money-lenders who conduct their business honestly and whose dealings are above board will soon find that they have nothing to lose from enactments which regulate rates of interest, insist on the maintenance of proper and regular accounts and the furnishing of accounts and receipts to debtors, restrict usufructuary mortgages to a reasonable number of years, allow debtors to redeem certain old mortgages and in general protect the ignorant cultivator from his own folly. Such legislation stands in a different category from legislation which presumes dishonesty on the

part of the creditor. It only requires him to conform to certain standards and by doing so tries to ensure that he will not take undue advantage of the ignorance or necessity of the borrower. Companies, banks, and insurance companies which have to deal with an enlightened public are required to submit to regulation and there is no reason why moneylenders who have to deal with illiterate ryots should claim exemption. We are therefore in favour of reasonable legislation regulating moneylending and making registration compulsory for all moneylenders. We suggest further that apart from any penalties which might be prescribed in such legislation for violation of its provisions a procedure should also be devised for the inspection of the accounts of moneylenders. This will impose a salutary check which will be more effective in eliminating malpractices than any other sanctions. If the business of moneylending is regulated in this manner it will also be possible to obtain more accurate information regarding the incidence of agricultural indebtedness by reference to the account books of the moneylenders and measures to deal with it can then be discussed on surer grounds. It will further be possible to create a privileged class of moneylenders who may be licensed and approved for dealings with the Reserve Bank on conforming to our regulations on the general lines suggested in Chapter V for indigenous bankers and in the special manner indicated in para 41, Chapter IV.

12. Legislation relating to the scaling down of debts and the grant of instalments stands on a different footing. These scaling down of old debts are definitely emergency measures to be justified only by the occurrence of unusual circumstances. Their effect in frightening away credit cannot be minimised but the exceptional circumstances themselves have a similar effect. If statistics could be collected it is more than probable that it would be found that the flow of agricultural credit had become impeded as soon as the depression started, and before protective measures

for borrowers came under consideration. Such measures should be looked upon as an attempt to solve the deadlock and if they are successful in this they will obviously be not less beneficial to the creditor than to the debtor. Almost every agricultural country in the world has found it necessary during the depression to adopt some measures of the kind and so long as both the people and the Government realize that they are essentially emergency devices whose aid is not to be invoked in normal times they are more likely to do good than harm. In this connection we would also like to reiterate our previous recommendation regarding the enactment of a simple rural insolvency law for dealing with the cases of hopelessly involved cultivators and in particular those carrying heavy burdens of ancestral debts. Where, however, there is chronic indebtedness and debts accumulate because the cultivator's income is not sufficient to leave him a reasonable margin of profit, the mere scaling down of debts cannot provide a permanent cure. Even a limitation on the rate of interest which can be charged by the moneylender (if it could be enforced) is not likely to do much good as the rate of interest is not the only cause of the cultivator's inability to repay. Such chronic indebtedness requires a comprehensive policy aimed at improving the whole life and economic status of the agriculturist.

CHAPTER III.

THE CO-OPERATIVE MOVEMENT.

13. With regard to the co-operative movement in India it is possible to quote an imposing array of figures about the number of societies, their membership, working capital, loans, etc. These figures, however, do not reveal the real state of affairs and a closer scrutiny shows that the position is far from satisfactory in some of the areas. The figures for the British Indian Provinces for the year 1934-35,
Present position of the movement.

which are the latest available show that the number of agricultural societies was 78,253 but about one-third of them were classified as D or E, which means that they were not working properly or were on the verge of liquidation. The total membership of these societies was 2,552,623 which is only 1.06 per cent. of the rural population. Even calculating on the basis of families of 5 persons each, the movement had not reached 6 per cent. of the families. The total working capital of these societies was Rs. 30,75,44,661 of which almost three and a half crores represented paid up share capital and a little over six and a quarter crores reserve funds. Since share capital in primary societies may in certain cases consist only of an inflation of the loans granted to members it is doubtful how much of it represents real savings. The practice of allocating even unrealized profits to reserves obtaining in some provinces makes it difficult to gauge the real strength of the funds. The loans outstanding against members amounted to about twenty-four and a half crores of which ten and three-quarters were shown to be overdue. The practice of granting renewals and the procedure followed in one province of fixing demands every year at the time of harvest and counting as overdues only such sums as fall short of the demand makes it probable that the real arrears are still larger and that frozen loans form a large part of the outstandings. The amounts lent to members and those recovered in 1934-35 were practically identical, being slightly less than five crores. This figure by itself shows what a small part co-operative societies are playing in the finance of agriculture but even this amount probably does not represent the actual cash outgoings and incomings and includes various book adjustments. When the statistics of all the provinces are combined the general picture is undoubtedly unfair to some, such as the Punjab, Bombay and Madras in which the movement is in a better condition, but it also on the other hand serves to cover the correspondingly weaker position in others.

14. It becomes clear, therefore, that if the co-operative movement is to play in agricultural finance the prominent Measures for and beneficent part for which we consider rectification. it to be specially qualified, considerable rectification and consolidation will be necessary. It was with this object that in our preliminary report we made certain suggestions which we venture to repeat and elaborate because we do not think that they received the attention which they deserved, and because, in certain quarters, their purport appears to have been misunderstood. They were (i) that the overdues and long term loans should be separated and put on a proper footing, (ii) that in order that the societies should be able to grant extensions or remissions in case of crop failures they should build up strong reserves by keeping an adequate margin between their borrowing and lending rates and (iii) that future loans should be restricted to such sums only as could be reasonably expected to be repaid out of the harvest.

15. We cannot lay too strong an emphasis on our first recommendation. We consider that the policy of letting Separation of overdues. things slide with palliatives like temporary extensions and reduction of interest in the hope of better times as well as that of vigorous coercion and liquidation can only result in the gradual extinction of the movement. Where the question of overdues has become serious the co-operative movement has ceased to function as an agency for the supply of agricultural credit and many who are nominally members of co-operative societies are being driven to have recourse to moneylenders. The overdues choke the flow of credit and must be tackled in a practical manner without delay. Our previous recommendation in this respect was that these overdues should be brought down to a level at which there was a reasonable prospect of repayment out of the profits of agriculture within a reasonable period, say twenty years, partly by writing them off from reserve and other funds and partly

by recovery from sale of part of the member's assets and spreading out the remainder into instalments and transferring them to some special agency equipped to deal with long term credit facilities such as a land mortgage bank. It may be argued that it is difficult to follow this course particularly when the funds of the society are not sufficient to cover the losses. Where this is the case it is better to face the facts and to decide what agency can best bear the losses. Liquidation of the society is by itself no solution as even after selling up the members, the result may only be the acquisition of land by the society and losses may still be left uncovered. Liquidation also not only kills the society but brings the movement into disrepute and leaves a void in the structure of agricultural finance. It is better to follow the bolder policy of deciding at the outset what losses are inevitable and to make provision for recovering the rest in easy instalments. Side by side with this reconstruction it is necessary that the societies should be reformed on the lines recommended later in this report.

16. Our second recommendation has been criticised under the misapprehension that we desired co-operative societies

Building up of reserve funds. to increase their lending rates irrespective of the rates at which they were able to get deposits and in spite of their having built up substantial reserves. All that we wish to point out is the danger of working on inadequate margins and the necessity of accumulating proper reserves as a provision for losses so that the society may be able to be of greater service to the members in times of distress and may not be forced into liquidation or a state of suspended animation as at present on the occurrence of crop failures. The attempt to make credit cheap can and has sometimes been carried to the extent of being suicidal. It must be remembered that low margins are possible only when the agriculturist is an economic holder and has been over a long period generally prosperous and creditworthy. Where crops are notoriously insecure and the chances of loss are great the

price of credit must inevitably be high if the credit institution is to be worked successfully both as a business and as a co-operative organisation. We consider that the levying of rates of interest fixed in consonance with business prudence will not make such a great difference to the agriculturist as is usually made out. In a society which is really co-operative the members should, by virtue of their co-operative activities and thrift, be able to make sufficient profits to pay a higher rate of interest to make the society self-supporting.

17. Our third recommendation has also been misunderstood and even though we explained at some length that ~~Restriction to~~ crop loans did not mean loans for cultivation purposes only but included other loans required by the cultivator, so long as they were restricted to an amount which could be repaid out of the harvest and that for such purposes as the purchase of cattle, loans for two or three years might be allowed so long as they were limited to a comparatively small proportion of the societies' business, it has been thought that we overlooked the various needs of the cultivator and failed to allow sufficient latitude to the societies to meet these needs. It goes without saying that if the co-operative societies are to be worthy of their name and not to be mere substitutes for the moneylender they must see that the member borrows as far as possible only for productive purposes and that loans for other purposes which though not strictly productive are absolutely necessary, are reduced to a minimum and do not exceed his paying capacity so that he is not encouraged to live beyond his means. Our object, however, was not so much to suggest restrictions regarding the purpose of the loan as to point out the necessity of co-operative societies confining the major portion of their business to strictly short term finance to lessen the chance of the loans falling into arrears and of the society's ability to finance its members in the future being impaired by the freezing of its assets.

18. An important recommendation which we should like to add is one advocated in our bulletins, namely that the Reconstruction of village societies on sound lines. primary society which is the pivot of the whole movement must be re-established and reconstructed on sound co-operative lines, so as to bring the whole life of the cultivator within its ambit. In the bulletin on the village co-operative bank, the Officer-in-Charge of the Agricultural Credit Department has explained at length what he considers the proper functions and organisation of these primary units. We are in general agreement with his conclusions though we do not wish to offer his detailed proposals as more than suggestions for examination in the light of local conditions. We therefore, do not propose to recapitulate his suggestions at length here but we wish to emphasize that no amount of paper organisation in the upper structure, in the provincial bank or the central banks, will compensate for the lack of healthy vitality at the roots. The foundations must be sound and the primary societies on which the whole structure rests must be composed of individuals who understand the aims and objects of the society, the liabilities which membership imposes and the rights it confers, and who are imbued with the co-operative spirit and are determined to improve their economic condition by joint effort rather than by reliance on others. The primary societies must realise the necessity of building up their own funds with shares and reserves and of teaching the lesson of thrift and prudence to their members and attracting deposits from them. The society must stand the test which we have prescribed for the agency most suitable for agricultural finance; it must not be merely an agency for supplying finance but an influence for the all sided development of agriculture and the betterment of the life of the villager from every point of view. We realise that where special financial liability is to be incurred or caste and other considerations are involved it may be necessary to have separate off-shoots of the parent society, but the central idea should not be lost sight of.

The further suggestion made in the first bulletin, that in order to achieve this purpose the primary societies should be federated into small banking unions of the type recommended there, also in our opinion deserves consideration. The opinion which was expressed by one of the foreign experts who visited India to assist the banking enquiry which was cited by Sir George Schuster during the Assembly debates on Section 55 of the Reserve Bank of India Act may be repeated here:

"We were profoundly impressed by the character of the cultivators whom we met. No country possesses better material on which to build a great civilization. But we were also profoundly impressed by what there is still to be done to improve their economic position and by the extent of the failure of the co-operative movement in that direction in spite of good work that has been done by co-operators. That failure in our view has been due to failure to realise that credit organizations alone can never provide an effective remedy for the indebtedness of the cultivator. His position can only be improved if the full force of the co-operative movement is brought to bear on him at every point in the sphere of education, of better living, of better farming and of marketing. There will be no limit to the results which can be achieved if the same enthusiasm is shown in promoting development in these ways as has been shown at any rate in developing the growth of the credit movement".

19. As in the case of credit we consider that for developing co-operative marketing a start has to be made from the bottom. The present co-operative commis-marketing. sion shop consisting of members belonging to different villages, many of whom never make use of the shop while the rest sell only part of their produce through it, does not serve much useful purpose. A better plan would

be to induce primary societies to take up joint marketing. It should be their duty to ensure the loyalty of the members and they should aim at selling their produce as far as possible in bulk, ensuring uniformity of quality by supplying approved seeds to their members. They should be assisted to build up inexpensive but serviceable godowns not so much for the purpose of holding up the produce as for facility of collection. We consider that both Government as well as land mortgage banks could usefully utilise their funds in making long term advances for the building of godowns. It is only after such organisations have been first gradually built up and are working successfully that it is possible to organise large central sale societies which would be in a position to undertake the much more technical tasks of grading, processing, stabilising prices by orderly marketing and providing against losses by hedging, straddling and similar operations. We consider that such central societies could become one of the best means of ensuring a fair price to the cultivator and establishing contact between him and the money market but we must emphasize the need for preparing the way by small properly organised local beginnings. We wish also to reiterate our previous recommendation that a large marketing organisation if it is to be worked successfully must employ persons with experience and knowledge of the market and cannot be directed by non-experts only.

20. As regards the central and provincial banks, there is also large scope for reform. There has been a considerable increase in the number of societies affiliated to some of the central banks;

Central and provincial banks. There is one bank which deals with as many as 680 societies. Where such large expansion has taken place the work has become unwieldy and the co-operative character of the bank tends to become slender. In such cases even if the central bank is to be retained it seems necessary that societies should be grouped into banking

unions. We also feel that a provincial bank as the apex institution can play a much wider part in the direction and guidance of the movement. It is in a sense the Reserve Bank of the movement. As such it should be responsible for giving a correct lead to the other co-operative banks on banking and financial matters. By insisting on the observance of correct principles it can materially improve the working of central banks. It should also serve as the development department for the co-operative movement, where a provincial institute or union does not exist for the purpose or does not function properly. Where such an institution does exist the provincial bank should work in collaboration with it and should take an active part in helping primary units to broaden their basis, in the reorganisation of the movement and in the extension of principles of co-operation to other spheres. The sound provincial and central co-operative banks at present find themselves in the dilemma that though they are able to attract plentiful deposits at cheap rates they are unable to utilise them to any appreciable extent in making fresh advances to primary societies on account of the heavy overdues outstanding against the societies. It is therefore in the interest of the banks that they should take an active part in the reorganization of the societies so that the old outstandings may be cleared and fresh financing on a much larger scale and for more varied purposes may become possible. We consider that by interesting themselves in all activities calculated to tone up, consolidate and expand the movement, the provincial banks will make themselves far more useful than if they restrict their role to finance only.

21. There is another important direction in which the central and provincial banks can be reformed. When the Re-organisation co-operative movement was started in India on banking lines, before the Great War, modern banking was for all practical purposes confined to the larger towns; commercial banking as a means of supplying the interior of the

country with credit was in its infancy. Since then, the Companies Act has been passed with its detailed provisions for the regulation of joint stock banking, for the restriction of their business to true commercial banking and for the maintenance and publication of proper accounts. Our own Act also makes provision for the supply of accurate and up-to-date information by the scheduled banks to us regarding their weekly position. We consider it essential that those responsible for the co-operative movement in the various provinces should take account of these developments and should re-model their banks accordingly. We realise that immediate and absolute uniformity is impracticable but the more active progress is made along these lines the better.

22. In particular, co-operative banks must maintain sufficient fluid resources to provide for the withdrawal of deposits. In some provinces the Registrars have laid down standards for fluid resource but they do not seem to be always followed and in some provinces there seem to be no rules at all. The degree of fluidity of sound commercial banking should even be surpassed by co-operative banks in view of the much longer periods for which agricultural loans are granted as compared with commercial credits. They must also as in the case of primary societies maintain a sufficient margin between their borrowing and lending rates not only to meet their expenses but to build up their reserves. All the amount taken towards income must be actually realised and must not include any unrealised or unrealisable interest which has been added to the capital of the loans. The practice of carrying on bad debts from year to year without any proper scrutiny of the extent of the losses likely to occur on the one hand, and of large nominal provisions for bad debts out of unrealised profits on the other merely hides the real state of affairs not only from the public but also not unfrequently from those in charge of the movement. Much stricter provision must be made for setting out overdues both of principal and interest in

the balance sheet which should specify the maturity of the loans by categories, e.g., under six months, six to twelve months, one to two years and over two years. The balance sheet must be prepared in such a way as to present a true picture of the condition of the bank and must be published with the punctuality and promptitude now insisted on in the case of commercial banks. One of the greatest difficulties in forming an objective view of the co-operative movement is the extraordinary diversity in practice between the various provinces in the matter of setting out assets and liabilities. There is no reason why co-operative banks should be in any way less responsible for publishing a properly drawn up and easily understandable account than the commercial banks and it seems to us necessary that the balance sheets of co-operative banks should be prepared in a uniform manner on the lines of Forms F and G under the Indian Companies Act with suitable modifications. We are considering such modifications and will approach the Provincial Governments to take steps to bring these forms into use.

23. It is sometimes argued that there is no need for change and that the co-operative banks, even constituted

as they are, can attract sufficient funds.

Necessity for developing resources so as to dispense with outside backing.

To this it may be replied without exaggeration that without the feeling that Government was behind the movement many of them would be unable to attract the deposits required even to maintain their present condition which in the case of some is one of stagnation, much less cope with the increasing requirements of the country. Government backing may have been necessary at the start but the ideal of the movement should be to become self-supporting as soon as possible. Co-operative banks must try to achieve this by organising their business on the lines advocated above. Until they have built up adequate resources, to pass on the low rates, at which Government backing

enables them to borrow, to the debtor with margins far lower than those which even the most optimistic commercial practice could condone is as pernicious to the borrower as it is ultimately disastrous to the lender.

24. It is a fallacy that because co-operative banks have to serve the needs of agriculturists they cannot be run on strictly banking lines. On the contrary, it is only in so far as the co-operative banks are good business concerns that they will be able to give real help to the agriculturists. On account of their more specialised acquaintance with agricultural conditions, the provincial and central banks are in a position to render useful service but if they are to fulfil this role they should reorganise their activities on the lines of commercial banks. As we have already explained, we do not consider it practicable in view of the past commitments of these banks that they should immediately recast themselves on exactly the same lines as joint stock banks. The process will have to vary from province to province according to the position of each bank, but we consider that the final object should be definitely set out and if this principle is recognised we will be glad to render such technical assistance as we can towards such reconstruction, having regard to the individual circumstances of the various institutions. We consider that it would contribute greatly to the health of the co-operative movement if closer contact could be established with first class commercial banks throughout and that those in charge of the movement in various provinces should get into touch with these commercial banks and take their advice in reorganising their business. Closer contact can also be established by co-operative banks making more use of commercial banks of standing for investment of their surplus funds as well as for obtaining credit from them on Government paper or otherwise. Commercial banks might also on their part utilise co-operative banks for the collection of bills in small places where they have no

Closer connection with commercial banks desirable.

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Closer connection with commercial banks desirable.

offices of their own. Such mutual dealings will promote mutual understanding and bring the co-operative bank more into touch with the commercial.

25. We should like at this stage to emphasise one most important principle namely that sound banking is the result not so much of banking rules as of good bankers. In addition to the large class of those with a hereditary training in banking there is now a large and rapidly growing supply of young and active trained Indian bankers and nothing would be more helpful to the development of co-operative banks on banking lines than the recruitment of such trained staff to a far greater extent than in the past. We feel that several of the deviations from the orthodox banking path which have occurred in the co-operative banks and which have contributed to their present difficulties have been due to the lack of proper banking knowledge on the part of the staff and sometimes even of those entrusted with the direction of the movement. In addition to taking new recruits trained in banking, the co-operative banks must make provision for the training of their existing staff in banking theory and practice. We further think that the provincial and more important central banks would benefit greatly if they could have some professional bankers on their boards. Their presence would not only serve to put a brake on any tendency to deviate from courses dictated by banking theory and practice but would also enhance the credit of the movement in the money market.

26. In our preliminary report we have discussed the short term and long term needs of the cultivator separately and in connection with the latter we have referred to the co-operative land mortgage banks. The question of such banks has of late assumed such importance that we propose to deal with it in detail in a separate bulletin which we shall

be issuing shortly and we shall therefore indicate our views only briefly here. In the first place we should like to remove a misunderstanding which appears to have arisen over our general remarks in regard to these in our previous report. The statement that the advancing of funds for the liquidation of old debts is not the function of a banking institution as generally understood has been taken to mean that we were questioning the very necessity for long term credit. What we meant to convey was that ordinary banking institutions are not suitable agencies for the supply of long term credit, and that these required special organisations.

27. Our investigations into the working of the land mortgage banks in India reveal that in the liquidation of old debts to which they are at present devoting their almost exclusive attention they are running the risk of falling into the same error which was committed by co-operative credit societies in the past and which is to a large extent responsible for the present plight of the movement, and that there is a danger of the land mortgage banks finding themselves ultimately in the same position as some of the co-operative banks with their assets frozen. A cultivator who is habitually running into debt cannot be saved merely by the grant of longer instalments with lower rates of interest. He must be trained and disciplined in the use of money and if he is living on a deficit economy attempts must be made to increase his margin of profit. The old co-operative ideal was to make a man undergo a period of probation in a co-operative society and to liquidate his old debt only after his fitness for this purpose had been tested. The present system in vogue in many places of taking up debtors without any previous knowledge and looking only to the security offered by them can hardly be said to have any real co-operative element in it. The security of land, as has been demonstrated more than once, proves more an embarrassment than an

asset when it has to be realised on a large scale so that even a land mortgage bank must look more to the paying capacity of the debtor than to the mere value of his assets. We consider it highly desirable that arrangements should be made for the person whose debt is to be paid by the land mortgage bank to serve a period of probation with a good primary credit society and that even after the land mortgage bank has advanced him a loan he should continue to be a member of a multiple purpose society so that the regular repayment of his instalments may be ensured by proper supervision of his activities.

28. Such an arrangement will also help the primary societies, which in the past have sometimes felt the necessity of liquidating and paying off previous debts of members before any dealings could be started with them, with the result that

Co-ordination of credit societies and mortgage banks. the volume of credit required by these societies has been greatly increased. After a debtor has served his period of probation with a village society, if it is found that his existing burden of indebtedness is obviously beyond his capacity to bear and such as to disqualify him for help from a land mortgage bank, Government might appoint conciliation boards which would reduce the capital and interest to a level at which he will be eligible for a loan from the mortgage bank. If this is done, the credit requirements of the primary society would be very materially reduced and could be mostly confined to advances for meeting the current expenses of cultivation. A member who did not show the co-operative desire to improve his position and who could not therefore be assisted by a land mortgage bank could be ejected from the society. In this way the society would not be burdened with the liability for the indebtedness of bad members.

29. Though as we have already said the preoccupation of land mortgage banks with the liquidation of old debts was improvement inevitable in the beginning and was probably a necessary step to clear the ground before any work of a constructive nature could be undertaken we deprecate too exclusive concentration on that object to the neglect of the far more important work of supplying finance for the improvement of land which would be productive of permanent benefit to the agriculturist. After all, the main purpose of a long term loan raised on the security of land should be the improvement of the land itself. It is true that the demand for this kind of loan is small at present. Even the provision which Government has made for the grant of loans for this purpose has not been availed of to any great extent. The decreasing returns from agriculture owing to the slump and the increasing fragmentation of holdings have given a further set back to any desire for effecting improvements which cost money. There can be no doubt, however, that there is need for improvement in many directions. For works of permanent improvement such as the erection of bunds, the installation of power units, levelling, fencing, etc., on a large scale, the digging of wells, reclamation, etc., the expenses of which can only be met out of the return from the increased production over a series of years, long term loans are necessary and land mortgage banks will be failing in their true purpose if they do not undertake this kind of finance. If people will not come to the banks of their own accord for such assistance it will be necessary for the banks to carry on propaganda for the purpose. They should make known the special facilities which they would be in a position to give for works of improvement, the amounts which can be advanced and the instalments with which they can be repaid. Special efforts might be made in selected areas and help might in the beginning be confined to people approved and recommended by co-operative societies. As the lack of

compactness of the holdings often makes land improvement works unprofitable or impossible, land mortgage banks should also directly or indirectly encourage schemes for the consolidation of holdings. There are no doubt other difficulties in the grant of loans for improvements. It is for instance not free from doubt whether such loans on the mortgage of ancestral land could be binding on the co-parceners of a Hindu joint family including minors, but this difficulty could be got over by legislation. There are other minor legal hindrances of this nature to the working of land mortgage banks and wherever they are being established special legislation on the lines of the Madras Land Mortgage Banks Act seems essential if they are to function properly.

30. The need for the greatest caution in making advances for land improvement is obvious. One important reason for

Co-ordination with Agricultural Department. the reluctance of land mortgage banks to take up land improvement finance is their

inability to get technical advice and to supervise the use of their loans, and it is here that the co-operation of the Agricultural Department of Government could be of considerable assistance. The Agricultural Department is primarily concerned with the improvement of agriculture and it is on its advice that loans under the Land Improvement Loans Act are at present granted by Government in most of the provinces. In areas selected by land mortgage banks for advancing land improvement loans Government might discontinue granting taccavi loans, and where the Agricultural Department approved of a land improvement loan being given to any landowner it might forward the case to the land mortgage bank. The local officers of the Agricultural Department could then help the banks in (a) propaganda and education of the cultivators in the facilities offered for the financing of land improvement, (b) assistance to cultivators in the preparation of suitable schemes for financing and (c) examination of the technical aspects of schemes submitted and inspection of

subsequent progress after they had been put into effect. Before the volume of applications increases it will be necessary for the bank to maintain its own technical department but in the beginning such help should be rendered by the Agricultural Department. Mr. Jenkins, Director of Agriculture in the Bombay Presidency, to whom we are indebted for some of the views expressed above, considers that the financing of such land improvement schemes by the large mortgage banks would materially facilitate and implement the work of the Agricultural Department in the introduction and extension of agricultural improvements, many of which involve expenditure, which under existing circumstances is difficult to obtain.

31. In order to infuse new life into the societies, introduce the various reforms we have suggested and

The Co-operative Department. secure the growth of the movement on right and sound lines a highly progressive, efficient and well-trained staff is a vital

necessity. The MacLagan Committee and the Royal Commission on Agriculture have both laid great stress on the intensive training of the staff in co-operation and rural economics. To these we would add the theory and practice of banking. The facilities existing for the training of the co-operative staff in most of the provinces do not yet seem to be adequate and much lee-way has to be made up. Since the Registrar forms the foundation of the whole movement his training in co-operation, banking and rural economics requires the greatest possible attention. The MacLagan Committee set up the following very high standards for him:

"In order to fulfil his duties he must be continually studying co-operative literature, which is now most extensive; he must make himself acquainted with economic conditions and practices both throughout India and in his own province; he must know the principles and methods of joint-stock banking; and must examine the systems of developir

thrift and inculcating co-operation which have been tried in other countries. He is also head of a teaching establishment, and must devise effective means for impressing a real knowledge of co-operation on the bulk of the population. He has further to control a large staff, to draft model bye-laws and rules, to collect statistics and write reports, to advise Government on various subjects, and to keep in close touch with the higher finance of the movement as managed by Provincial Banks and Central Banks. He must keep in constant touch with markets. His work is highly responsible involving a watch over large sums of money deposited by the public and a share in the responsibility for the economic fate of a province. It can well be realised that few officers are entrusted with work more serious or more exacting. In dealings with other departments and with outside bankers and business men it is important to have as Registrar an officer of some standing, and it would in our opinion be a grave dereliction of its duty for a Local Government to entrust interests of so vital and so far-reaching a character as those controlled by the Registrar to any but picked officers of experience and authority. It would in our opinion greatly enhance the usefulness of Registrars if the Local Governments were to enable them from time to time to make short visits to other provinces for the sake of studying, in the company of the local Registrar, the systems prevailing in parts of the country outside their own jurisdiction."

To these qualifications laid down by the Committee the Royal Commission added the following: "The modern Registrar must be fully abreast of the activities of all departments working for the improvement of rural conditions; he must see that there is a sound foundation of Better Business to support the superstructure of Better Farming and Better Living; the more efficient the movement, the more will other departments make use of it to promote their own special activities". It recommended that "Local Governments should

select the best man available as Registrar; on no account should the post be regarded as a convenient refuge for an official promoted by seniority to Collector's rank. Administrative experience, knowledge of the people and their economic conditions and ability to enlist the co-operation of honorary workers are essential qualifications. A Registrar, once appointed and proved efficient, should not be transferred from the post until the full benefit of continuity of policy has been assured. The minimum period during which he should hold the appointment should not be less than five years, on the assumption that he has already had two years service as Assistant or Joint Registrar and the maximum not more than ten..... The movement is gathering force so rapidly in some provinces that the post of Registrar is becoming one of the most important under the Local Government and should be recognised as such". The Commission also considered it desirable that the Registrar should be sent on deputation to study conditions in Europe and that such deputation should be usually preceded by considerable study and experience of the movement in India. It also regarded as unsatisfactory the practice of combining the Registrar's office with various other duties and considered that the appointment of a full time incumbent would assist in removing the defects of the movement. We have given these lengthy quotations because we feel that no every Provincial Government has given these valuable recommendations the attention they deserve. The non-observance of these principles has resulted in hampering the progress of the movement in some of the provinces and we strongly recommend them to the serious consideration of the various Provincial Governments. We feel that if the movement in the Punjab is in a better condition than in most other provinces this is to a great extent due to the provision of adequate and well trained staff as well as the appointment of specially trained officers as Registrars who have made a close study of the co-operative movement in India and abroad. In some of the provinces the staff is not

only untrained but it is complained that it is inadequate. In one province our Agricultural Credit Department has noticed that the accounts of co-operative societies have remained un-audited by Government staff for nearly two years. Economy in this respect is clearly pernicious and we would recommend the Provincial Governments to consider the necessity of strengthening the staff wherever it is deficient.

32. The various suggestions that we have made in this Chapter for the improvement of the co-operative movement should not be construed to mean that none of the provinces are at present taking any steps to reform the movement in some of these ways. It is in fact the knowledge of the good effects which some of these measures are producing in several places that has prompted us to advocate their adoption elsewhere. What we wish to draw attention to is the necessity of a comprehensive reform of the movement as a whole based on a broad conception of the fundamentals of the problem and it is with this view that we have suggested various remedies necessary to strengthen the movement at every point even though some of these are already being tried in particular provinces. We feel that it is only if the movement is reformed in such a comprehensive manner that a real improvement can be brought about.

CHAPTER IV.

CO-ORDINATION WITH THE RESERVE BANK.

33. Before going on to deal with indigenous bankers it will be desirable at this stage for us to explain our position
Public ex- vis-a-vis the various credit agencies. One
pectations. of the charges which has been levelled
against the Reserve Bank is that we have failed not only

to assist agricultural credit by direct monetary help but also to give any indication of the lines on which we would be prepared to grant such help. From the trend of criticism it appears to have been expected that the Reserve Bank would be in a position to place practically unlimited credit at the disposal of agriculturists. As this criticism is clearly due to a misapprehension of the legitimate functions of a Central Bank in the sphere of agricultural and other credit it seems necessary to explain some of the fundamental facts regarding our constitution and functions.

34. As will be seen from the preamble to the Act the Bank has been established "to regulate the issue of bank notes and the keeping of reserves with a Bankers' Bank, with a view to securing monetary stability in British India and generally to operate the currency and credit system of the country to its advantage". As one of the essential measures for enabling the Reserve Bank to maintain control over the banking structure of the country, the Act compels all banks with capital and reserves of five lakhs and over to keep two per cent. of their time liabilities and five per cent. of their demand liabilities with the Reserve Bank. The Bank thus holds the cash reserves, or the fluid resource against deposits of all the important banks. A glance at the balance sheet of our Banking Department will show that these reserves form by far the largest portion of our working capital. This being the main origin of the resources of the Reserve Bank it will be easy to understand why it has to be the Bankers' Bank in emergency and not their ordinary financing agency. The funds which scheduled banks are compelled to keep with it so that the entire pool may be available in times of emergency cannot be locked up by us in forms of business which the scheduled banks themselves would not undertake on account of the risk, the length of the period, the lack of liquidity or other rea-

sons. This is why the Reserve Bank keeps such a large portion of its funds in hard cash and invests most of the remainder in readily realizable Government Securities and Treasury Bills. This is also the reason why the business which it is allowed to undertake by the Act is limited in period and to securities which are self-liquidating in character.

It is obviously, therefore, impossible for the Reserve Bank to lend to agriculturists direct or to advance large sums to co-operative banks or indigenous bankers for being lent out to cultivators as a matter of course. Nor can the Reserve Bank take the place of the Government. The high expectations which appear to have been entertained in some quarters regarding the part the Reserve Bank could take in agricultural finance seem to a large degree due to the impression that since it was assuming some of the functions of the Government it could play the same or even a larger part in the matter of agricultural credit. It must be clearly understood that what can be done by a Government with its own revenues is not open to the Reserve Bank in view of the limitations inherent in its constitution.

.35. From the financial point of view, India is a new and still almost undeveloped country. If it is to become finan-

**Necessity of
building up pri-
mary credit
agencies.**

cially self-contained and to develop as it should, the most rigorous conservation of its still meagre financial resources will be necessary. They must be distributed only

where they are best likely to fructify and assist in the development of the country. What this means in practical form is that the banking and investment habit in the country must be encouraged and strengthened. One essential for this development is the confidence of the public in the banks. This confidence can only be achieved as the result of conservative and sound business methods and management. Credit agencies must, therefore, clearly understand

that they must build up their own business on their own resources and on lines which do not involve reliance from day to day on an outside or even the central institution.

36. The alleged ability of a central bank to produce almost any desired conditions in the supply of credit has been the subject of much discussion in recent years, but the occasions and uses to which these powers may properly be applied are unfortunately not fully understood. During a period of financial development, such as exists in India to-day, it may be desirable for central bank credit to be made available in a larger number of ways and with less restriction than when the financial structure is more complete. But it can scarcely be said that such a need exists in India at the present time, when money is frequently unable to find any useful employment. Furthermore, it is no part of the functions of a central bank to provide directly day-to-day finance for banks and other institutions but rather to produce monetary conditions under which there will be adequate facilities for all those seeking credit for legitimate purposes or having funds to invest. For example, for the Reserve Bank to lend with the object of relieving previous indebtedness would create a vicious circle of inflation for which there would be no natural corrective except an ultimate collapse of the whole financial structure of the country.

37. From these remarks it will be apparent that the co-operative banks like the commercial banks must stand on

**Principles on
which Reserve
Bank can make
advances to co-
operative banks.**

their own legs and obtain their normal finance from deposits, and cannot expect the Reserve Bank to supply it or to act as the apex bank of the movement. Sound co-operative banks have in fact such a plethora of funds at present that they are forced to invest large sums outside the movement. The Reserve Bank can come into the picture only when the ordinary pool of com-

mercial credit appears inadequate to meet the reasonable business requirements of the country. In such conditions also the Reserve Bank must follow the same basic principles in making advances to co-operative banks as those for other forms of credit. The terms on which the Reserve Bank is authorized to lend to provincial co-operative banks are already laid down in sub-sections (2) (b), 4(a), 4(c) and 4(d) of section 17 of the Act. As, however, their implications do not seem to be properly understood in all quarters it is necessary to explain here that the financial accommodation which the Reserve Bank is authorised to give covers the following cases:—

- (a) Loans or advances against Government paper for ninety days to provincial co-operative banks and central land mortgage banks declared to be provincial co-operative banks and through them to co-operative central banks and primary land mortgage banks. sec. 17(4) (a).
- (b) Similar loans and advances to provincial co-operative banks and central land mortgage banks declared to be provincial co-operative banks and through them to co-operative central banks and primary land mortgage banks against approved debentures of recognized land mortgage banks, which are declared trustee securities and which are readily marketable.
- (c) Advances to provincial co-operative banks for ninety days against promissory notes of central co-operative banks and drawn for financing seasonal agricultural operations—Sec. 17(4) (c) or rediscount of such promissory notes maturing within nine months—Sec. 17(2) (b).
- (d) Loans and advances not exceeding ninety days to provincial co-operative banks against promissory notes of approved co-operative marketing or warehousing societies endorsed by provincial co-operative banks and drawn for the marketing of crops—section 17(4) (c) or rediscount of

such promissory notes maturing within nine months—section 17(2)(b); or loans and advances on the promissory notes of provincial co-operative banks supported by warehouse receipts or pledge of goods against which a cash credit or overdraft has been granted by the provincial co-operative bank to marketing or warehousing societies—Section 17 (4) (d).

38. It may further be explained that the Reserve Bank though it will be prepared to deal with provincial co-operative banks on the above lines must retain grant of advances the discretion to judge for itself the advisability and expediency of granting accommodation according to the circumstances of the time, and cannot make large permanent promises in advance. It will also have to insist on provincial banks which are approved for financial assistance maintaining financial statements in certain forms and submitting them periodically. It must also have the right to inspect such banks. Any accommodation granted will be on the credit of the provincial co-operative bank and it will be necessary for such provincial banks to maintain with us some minimum balance which will have to be prescribed by us from time to time to ensure that they are maintaining sufficient fluid resources. Above all it must be clearly understood that all that the Reserve Bank can do is to help the provincial co-operative bank to tide over a temporary shortage of funds and as the funds advanced must be repaid within the time limit allowed by the Act the co-operative banks cannot make use of them for the purpose of continuing finance. These conditions may seem stringent but as we have already pointed out the Reserve Bank has to work within the limitations imposed on it by the essential conditions of sound central banking and expressed in its constitution. We propose from time to time to issue instructions and circular letters indicating what are in our opinion the criteria of sound banking which would justify our making advances and also laying down the pro-

cedure for obtaining loans and advances when these conditions are fulfilled. We shall always be glad to give co-operative banks advice to enable them to organize the business on sound lines. A healthy competition among the provincial banks to conduct their business in such a manner that they will be in a position to obtain financial accommodation from the Reserve Bank when necessary will in our opinion be all to the good and we hope that they in their turn will influence the central banks to observe the same strictness so that the whole movement may be toned up.

39. The Co-operative Associations have from time to time made various demands for the extension of the provision

Demands of co-operative associations. of the Act. It has been urged that the Reserve Bank should supply normal agricultural credit to co-operative banks. We

have already explained that this is impossible. It has also been suggested that provision should be made for giving cash credit facilities to provincial banks. As we have pointed out there is already a provision in the Act for the grant of advances against Government securities for ninety days and for the reason given above we do not think that it is possible or advisable for any further provision to be made in this respect. Another suggestion is that the provincial co-operative banks of Indian States should be brought within the scope of the Act. We consider that this is a matter for the Central Government to decide in the light of the financial and other relationships with the Indian States. Another suggestion is that Section 17 (4) (d) which at present allows advances against promissory notes of provincial co-operative banks which have granted cash credits or overdrafts for financing the marketing of crops should be extended to include promissory notes given for loans and advances granted for the same purpose. Our investigations show that most of such financing is done through cash credits or overdrafts and in any case it seems to us premature to recommend such amendment of the Act at this stage. It has

also been suggested that Section 17(2) (a) should be amended to include the provincial co-operative banks in order that urban co-operative banks dealing with small artisans and traders may be able to approach the Reserve Bank through them. Such business has not yet developed to any great extent except in the Bombay Presidency where the provincial co-operative bank is in a position to satisfy all the demands. There does not therefore seem to be any urgency about this at present. It has also been urged that section 17(2)(c) which refers to advances for trading in securities should be made applicable to provincial banks. We do not think this desirable. Lastly there has been a considerable demand that the Reserve Bank should invest in the debentures of land mortgage banks and it has even been urged that provisions should be made for enabling the Reserve Bank to give long term rural credit. It is unnecessary to repeat again the incompatibility of long term finance with the functions of the Reserve Bank. Even in regard to the buying of debentures of land mortgage banks the Reserve Bank has to take care to see that they are easily marketable since it cannot lock up its funds and we consider it safer not to purchase them at this stage of our development. Though we have thus not accepted at present any of the suggestions made by co-operative organizations we are bearing in mind their requirements and if we find it necessary in future to approach the Government for any important amendments of the Act we shall consider them at the time.

40. Another matter which is exercising the mind of co-operators is the question of remittance facilities. The facilities for remittance of funds for bona fide co-operative purposes through Remittance Transfer Receipts at par has been continued by the Reserve Bank for the present. The separation of Provincial Revenues has, however, introduced complications as the cost of remittance now ultimately falls on the Central Government through the Reserve Bank and

the whole question is being examined by us in the light of the new conditions, and we hope to be able to formulate our views in the near future.

41. Though we have indicated above the manner in which we shall be able to assist the co-operative movement Co-ordination with the money-lenders. it is obvious that it will take years of rectification, consolidation and expansion before that movement can touch most of the primary producers. It is therefore, clear that unless the village money-lender who is the largest supplier of agricultural credit is brought within the banking structure, the Reserve Bank will not be able to influence or improve agricultural credit in an effective manner. There are, however, very great difficulties in establishing such contact between the money-lender and the money market as would be of material advantage to the agriculturist. On the general principle enunciated earlier in this Chapter it is not possible for the Reserve Bank to have direct relations with the money-lender. From the enquiries which were made before we submitted our preliminary report it was also found that money-lenders were not willing to abide by the conditions which would have to be imposed if the Reserve Bank transacted business with them. It is also generally believed that as a result of various debt legislation, the money-lender has curtailed his business to such an extent that he does not find full use even for his own funds. Further as we have already explained the risks involved in the financing of the production of crops are so great as to make it generally unsuitable for banks. The only type of agricultural loans in which banks may be expected to take an interest on account of the lesser risk involved, are those advanced on the security of produce. Unfortunately, loans for such a purpose do not appear to be generally taken by the small agriculturists. It is in this business that the money-lender can get financial assistance from banks and thus be brought within the banking structure to his own advantage as well.

as that of the cultivator. If the scheduled banks can develop this business and discount the bills of approved money-lenders drawn for advances to cultivators against produce, it would be possible to bring about a substantial improvement in this type of agricultural finance. We feel that if such a scheme could be brought into operation the mere force of competition will secure a great reduction in the rates of interest at which money will be made available to the creditworthy agriculturist. However, in view of the special responsibility which has been imposed upon the Reserve Bank in regard to agricultural credit and the desirability of taking some practical steps in the matter we would be prepared to rediscount such bills at special rates by the grant of rebates to scheduled banks in respect of such paper if we were satisfied that it was owing to inadequate financial machinery that the credit which ultimately percolated to the agriculturist was at unduly high rates and that the benefit of such rebates was being passed on to him. This concession should result in the greater willingness of scheduled banks to give advances to money-lenders for such purposes at a low rate of interest and the money-lender in his turn would be able to make finance available to the cultivator more freely and at a lower rate of interest than at present. This suggestion requires to be further examined in consultation with the scheduled banks and money-lenders. We wish, however, to do our best to develop agricultural credit on sound lines and though we are not at present in a position to put forward the scheme in a final form we are taking up the matter actively with the scheduled banks. As any such scheme would not require modification of the Act we shall, if we find it feasible and acceptable, put it into operation as soon as possible.

CHAPTER V.

THE INDIGENOUS BANKERS.

42. The indigenous banker as already mentioned by us is responsible for financing most of the inland trade and industries and also takes indirectly a considerable part in supplying agricultural credit. Unfortunately, from the point of view of bringing him within a co-operated system, his instincts are towards a highly personal regulation of his own business, and as he generally depends for such funds as he is unable to furnish from his own resources, or those of his family or caste relations, on the credit which he is able to obtain from the joint-stock banks without having to submit to any formal restrictions there is little inducement for him to submit to restrictions without a clear indication of corresponding advantages.

43. We made concrete proposals to the representatives of Indigenous Bankers and others in this connection based on the report of the Central Banking Enquiry Committee and in the light of recent legislation affecting Joint Stock Banks in the Indian Companies Act. These proposals are reproduced at the end of the Report in Appendix A. Very briefly, we suggested that if the indigenous bankers were to come into practical relationship with us, they would have to formalise their methods of business on lines approximating to Joint Stock Banks, and in particular, develop the deposit side of banking activities. We received 11 replies representing the different classes of Indigenous Bankers in various parts of the country. Generally speaking, they all disagreed with our suggestions regarding the taking of deposits and giving due publicity to accounts. Only some of them were agreeable to our conditions regarding the maintenance of accounts in approved form. Though they generally agreed that speculative business should be ruled out, none of them were

prepared to confine themselves to banking business only. Thus they desired our scheme to be so modified as to be incompatible with our main proposals. We reproduce in Appendix B and C, two typical replies, one from the Bombay Shroff Association, Bombay and the other from a Multani Banker, Madura.

44. We appreciate their point of view and we are inclined to think that the ultimate solution must be the development of an open bill market in which first class bills are freely negotiated. If such a market could be developed it would be possible for us to extend our open market operations to trade bills as we do at present to Government securities, and this would give first class indigenous bankers the closer and possibly ultimately the direct relationship which they desire without compelling them to modify the essential character of their business or to submit to unduly rigid restrictions.

45. At the same time, there are many difficulties in the way. The prevailing cheapness of money would make a free market even in Government treasury bills unprofitable, so that the marketing of trade bills with marginally less security would afford even less prospect of success under existing conditions. Even in the United States of America where the Federal Reserve System is ostensibly based on the bill habit, bills inspite of artificial encouragement appear to be falling into desuetude as a result of the cheapness of money and the greater cheapness and facility of other forms of credit. The second factor is not, however, applicable to India at present and until branch banking spreads more widely and makes the more elastic and tax-free cash credit more freely available to the public, bills will continue to be the most convenient form of credit. So long, however, as bills are not freely negotiated, they remain in essence nothing more than documents in which the debtor expresses his debt to his creditor

and it is obvious that so long as this remains the case our direct relationships must be confined to the scheduled banks whose business such lending is, and to those who are prepared to work under similar conditions.

46. There is also the additional difficulty in India that the rates of stamp duty, while possibly not inappropriate at times of high interest, now impose what is practically a prohibitory tariff on this form of document. This is a matter which we have taken up strongly with the various Governments in India and we hope that they will see their way to effect a reduction at an early date.

47. In the meantime, we are actively investigating the possibility of creating a bill market by encouraging the formation of acceptance houses, or in other ways, and will address the parties interested as soon as the reduction in stamp duty is brought into effect and gives us firmer ground on which to examine the practical possibilities of such a development.

48. In any case the creation of a bill market could not be brought about without some legislative regulation of the indigenous banker, and much examination and experiment will be necessary before the scope of such legislation could be defined. It would be premature and a waste of time to suggest legislation based on theoretical considerations before we had ascertained that the indigenous banker and the other parties concerned would be able or willing to work it. For this reason, we have also, in the light of the replies to our circular letters, decided that legislation on the lines indicated in our second letter would not in present conditions serve any useful purpose, and we are, therefore, not recommending it. At the same time, we would like to emphasize that the offer made in our letter dated 26th August 1937 is still open and that if the indigenous bankers indicate a desire to conform to our conditions or suggest some other practical alternative we will be prepared to take the matter up with Government with a view to legislation.

CHAPTER VI.

CONCLUSION.

49. We have now explained our general views and the frame-work on which we consider that progress should be made. We do not propose to lay down at this stage any definite and automatic rules on which we would be prepared to advance money. Such rigidity would be entirely contrary to the spirit in which the Reserve Bank was created, namely that it should grow and develop with experience. We realise that the most efficacious method of developing new channels of credit is by tentative experiments because it is only by practical experiment that errors can be detected and eliminated. To prescribe rules in advance which might be interpreted by some as unilateral pledges would merely impede development. We propose to issue from time to time bulletins and circular letters laying down such general principles as seem to us to be of general applicability and, what is more important, we hope, by friendly personal advice, to be able to assist in correcting errors which seem to us to be due to lack of knowledge or experience, and endeavour in this way to build up the structure of India's credit on solid foundations.

50. As regards actual legislation, it will also be apparent from what we have said above that we have few proposals to make at this stage. The most important proposal is one which we have already made in our preliminary report namely that the rates of stamp duty on inland bills should be drastically reduced. As regards co-operative banks, we would like to see them placed on all fours with scheduled banks but we recognise that they are not yet ripe for this and that to insist on their furnishing compulsory deposits at present would be unduly harsh. At the same time, we would like to reiterate that they cannot expect to

Proposals for
legislation about
the co-operative
movement.

attain full banking stature or to be treated on a level with other commercial banks until their organization and liabilities are on all fours with them. In the meantime, our powers under sections 17 and 44 of our Act appear to us to be sufficient for the time being.

51. As regards persons and firms not being scheduled banks engaged in British India in the business of banking, for the reasons indicated above, we have no proposals to make for legislation at present. At the same time our discussions with them have cleared the ground of misconception and we hope that before long we will be able to devise machinery to enable them to take their full place in India's credit structure, and to solve the problem of modernising their methods without imposing unduly rigid restrictions on legitimate business.

52. We have tried in this report to summarise the conclusions which we have reached so far. It is not to be expected that a cut and dried scheme which will remedy all the ills from which agriculture suffers can be put forward all at once. The method we have followed is to take up different aspects of the problem for intensive study and to suggest remedies as we go along. We consider that this method of approach is likely to give the best results in the end. In the Agricultural Credit Department we possess an organization which is being built up for this work and it is pursuing various lines of enquiry the results of which will be published by us from time to time in the form of bulletins. We have also been trying to fulfil our role as the clearing house for information relating to agricultural credit and have tried to put our best advice at the disposal of Provincial Governments and co-operative banks whenever we have been asked to do so. Thus we have assisted in the formulation of a scheme of sinking funds for the debentures of land mortgage banks, advised one province

on the bifurcation of a provincial bank and assisted another in the formulation of a scheme for the reconstruction of the co-operative movement. The Officer-in-Charge of the Department has also examined on the spot the efforts which are being made to resuscitate the movement in Burma and we hope shortly to publish our comments on recent developments in that country which we consider might be of value to India. We have given our opinion on the various measures relating to agricultural debts whenever we have been consulted. We were also consulted and gave our opinion on the amendment of the Companies Act in order to improve the regulation of banking companies. Our utility to Governments and the co-operative movement will depend on the use which they make of us. Above all it must be remembered that the Bank is not a committee or commission of enquiry which goes out of existence after reporting on a given problem. This report is not to be regarded as our last word on the subject. Problems of agricultural credit and indebtedness which have engaged the attention of legislators since the beginning of history can hardly expect final solution from us within three years of our creation. But the time limit has been of value. It has brought us to immediate grips with the problems which lie at the root of India's economic life, and which must be grappled with if India's development is not to be one-sided and ephemeral. We can only promise that these problems will have our unremitting attention, that we will give our full and friendly consideration to any practical suggestions about them from any quarter and express our hope that gradually, as we acquire experience by experiment, the Reserve Bank may be able to make a real contribution towards their solution.

Reserve Bank of India,
Central Office,
Calcutta, 15th December 1937.

J. B. TAYLOR,
GOVERNOR.

APPENDIX A.

Draft scheme for the linking of indigenous bankers with the Reserve Bank of India (issued after consideration of the replies to the Bank's preliminary proposal).

The replies are helpful and clear the ground in several important respects, but at the same time the replies from those who represent the indigenous banker appear to indicate some misapprehension of the role which the Reserve Bank as a Central Bank should play in the financial structure of the country and we, therefore, consider it desirable to set out at some length the basic principles on which we framed our proposals.

2. The history of the world since the war has made it abundantly clear that if a country is to be financially sound and independent it must have a properly co-ordinated banking system which will embrace all the important banking activities of the country and co-ordinate them in a well-ordered whole under the general supervision and control of its Central Bank. The essential feature of such a co-ordinated system is that the country should be covered by a net-work of banks (whether joint-stock or private is immaterial for the present purpose) organised and operating so as to command the confidence of the people of the country so that they may provide the necessary finance for carrying on the business of the country from the deposits which they obtain from them. In such a system it is only when additional finance is required for trade and industry either during seasonal stringency or in time of emergency that the Central Bank should be called upon to supply the necessary funds. It is not the function of a modern Central

Bank to supply the normal necessities of the market and thus compete with the commercial banking institutions.

3. The Indian Legislature in the last ten years has devoted a great deal of thought and trouble to the organization of joint-stock banks so as more adequately to fit them for this purpose. The Reserve Bank Act provided for the inclusion of the more important of them in a schedule subject to its control, and the amendment of the Indian Companies Act effected last year set out in much greater detail than has ever been attempted before the constitution and functions of such banks.

4. Unfortunately, these joint-stock banks still only cover a small portion of the field. In the smaller country towns and in the villages they are still either non-existent or play a very minor role in comparison with the private indigenous banker, and it is, therefore, obvious that if India's banking system is to be complete, provision must be made for the inclusion of the latter.

5. It is dangerous to generalise about the indigenous banker but a certain amount of generalisation is necessary if the problem is to be viewed as a whole, and as a broad generalisation it may be said that though in the past to a considerable extent and in the present to a smaller extent such bankers do take deposits from the public, they depend to a very much greater extent for their capital either on their own resources or on loans from other indigenous bankers or the commercial joint-stock banks. What we wished to emphasize is that so long as this remains the case they cannot be considered as eligible for central banking facilities. The nature of their business is such that only the commercial banks with their accumulation of experience and machinery for detailed local investigations are competent to gauge their creditworthiness.

6. The conclusion to which the Reserve Bank had come and on which it based its letter was that direct relationships could only be extended to indigenous bankers if and when they confined their activities to banking proper by making their principal business the accepting of deposits and generally adopting modern banking methods. The Reserve Bank has no predilection, as has been alleged in some quarters, in favour of the joint-stock principle as against private ownership but it does consider that the private banker must, in the interests of his customers as well as in order to bring himself within the banking framework of the country, organize his business on recognized banking principles and practices.

7. It has been argued that in taking this line we are inconsistent with past declarations and policy. On the contrary, our proposals appear to us to be in absolute accordance with the spirit of the majority recommendation of the Banking Enquiry Committee. In paragraph 139 of their report they say—

“It must, however, be remembered that the Reserve Bank can only rediscount bank endorsed paper. We therefore propose that only such indigenous bankers as are engaged in banking proper, or are prepared to shed their business other than banking, should be eligible to be placed on the approved list of the Reserve Bank in the same manner as joint-stock banks.”

They go on further to say in paragraph 144—

“It is quite conceivable that a large number of indigenous bankers whose principal business is not banking or who do not take to banking as their principal business as soon as the Reserve Bank is established, will still remain outside the scope of our proposals. These will continue to obtain their banking facilities from the

existing joint-stock banks, including the Imperial Bank of India.”,

adding that such bankers should be made eligible for central banking facilities if at a later stage they were prepared to satisfy the conditions prescribed for them by the Reserve Bank.

8. The Committee did not venture on a legal definition of ‘Banking’ which was for the first time defined in Indian Law by the addition of Section 277 F to the Indian Companies Act in 1936 defining a banking company as follows:—

“A ‘banking company’ means a company which carries on **as its principal business** the accepting of deposits of money on current account or otherwise subject to withdrawal by cheque, draft or order, notwithstanding that it engages in addition in any one or more of the following forms of business etc., etc.”

Thereafter ancillary activities are set out which are consonant with banking in the modern acceptance of the term and the Act goes on in Section 277G to make it clear that a banking company must restrict itself to these forms of business. It is clear from paragraphs 677 to 682 of their report that the views of the Committee were on the same lines.

9. These quotations and references taken together make it, to our mind, abundantly plain that both the Banking Enquiry Committee and the Legislature regarded the taking of deposits as the distinguishing and principal feature of banking and that they desired us to confine our direct relationships to such. The latitude which the Committee recommended should be left us was not to effect a breach in this basic principle but, as they clearly brought out in paragraphs 139 and 140 of their Report, to suggest what modifications, if any, we considered could be appropriately

effected as regards the minimum capital and the rule regarding compulsory deposits i.e., the subject matter of section 42 of our Act, when dealing with private as opposed to joint-stock banks.

10. The discussions which followed the publication of the Report of the Central Banking Enquiry Committee and those on the Reserve Bank Bill did not indicate any general desire on the part of the indigenous banker to limit and develop his business on the lines suggested by them. On the other hand the suggestion was made that direct access should be given to 'indigenous bankers' who conducted other forms of business if they were prepared to segregate the two and to keep separate accounts. It is quite clear that unless they give themselves separate legal entities in respect of these separate functions, the mere separation of accounts would be of no value at all. Liabilities incurred in respect of the one would have to be made good in the last resort from the assets of the other. We cannot conceive of any method whereby the two functions could be legally separated except by incorporation under the Companies Act and even this would not go far enough to meet the views of the Banking Enquiry Committee. It is obvious that even if they were legally separated an individual who was conducting the two separate types of business could draw on the assets of the one to meet the liabilities of the other so that even though the balance sheets in respect of the banking department seemed perfectly sound and satisfactory, the assets might be found to have disappeared when a call came to be made on them.

11. At the same time, we wished to go as far as we could to meet the natural reluctance of the indigenous banker immediately to abandon his various activities and we were therefore prepared to go beyond the recommendation of the Banking Enquiry Committee on this point and to allow the continuance of other than pure banking business so long

as there was clear legal segregation, in the hope that one or the other activity would eventually be discarded. However we may drop the suggestion of legal segregation by incorporation under the Companies Act as this suggestion has not received any support from the indigenous bankers

12. We must, therefore, go back to the recommendation of the Committee, which is that the only way in which it is practicable to admit indigenous bankers to direct access to us is their willingness to discard non-banking business and confine themselves to banking proper as defined in the recent amendments to the Indian Companies Act. If they are prepared to limit their business in this way, incorporation under the Companies Act is not to our mind a necessary preliminary. What is essential, as the Banking Committee points out, is that they should develop deposit banking on approved lines and that they should maintain accounts which will be properly audited and published. In addition, if a private banker does not wish to incorporate himself under the Companies Act, he would have to file a statement setting out the names and interest of his business partners, if any, and if he was a member of a joint Hindu family, the names and extent of the interest of the various co-sharers with similar statements from them testifying their willingness to assume their full share in the business.

13. The Banking Enquiry Committee did not suggest any precise figure for the minimum limit of capital. As our object is to encourage indigenous bankers to take up deposit banking so as eventually to fall into line with the scheduled banks, it is obvious that the minimum on which we should insist though it may be initially lower than that prescribed for the scheduled banks, should be one which is capable of being raised to the five lakhs prescribed for scheduled banks within a reasonable period, which we may, following the suggestion of the Banking Enquiry Committee, put at five years. We are *prima facie* of the opinion that the initial

requirement should not be less than two lakhs and in this regard we are provisionally in agreement with the suggestion made in several of the replies received to our previous circular, though we shall make our final decision in the light of the replies received to para 16 of this circular.

14. We would also, as recommended by the Banking Enquiry Committee, be prepared to forego insistence on a compulsory deposit for what may be called the experimental period of five years, subject to their proviso that the amount of time and demand liabilities remains less than five times the capital.

15. We would again like to make it clear that there would be no necessity for incorporation under the Companies Act during this experimental stage of five years and that during that period any banker who found those developments unsuitable would be at full liberty to renounce direct contact with us and revert to his original business. At the end of the five years, we would be in a much better position to put up definite proposals to the legislature, either for the framing of a separate Bank Act as suggested by the Banking Enquiry Committee or otherwise to standardise and co-ordinate the status of these registered private bankers on lines more in consonance with modern banking practice.

16. We are still, however, without any information whether these conditions will be widely availed of and we consider that it would be premature to take up the question of the detailed legislation which would be necessary to bring them into effect until this information is available. We would, therefore, be much obliged if the various organizations which represent the indigenous banker would ascertain from their members how many of them would be prepared to recast and limit their business on the lines suggested above. For the sake of convenience these conditions are summarised in the attached note.

17. We would also like to repeat that, again in accordance with the recommendation of the Banking Enquiry Committee, it was our intention that where indigenous bankers did not wish to organize themselves on the lines mentioned above they should be given the opportunity of developing their discount business and that the Reserve Bank, by agreeing to accept paper bearing names of approved parties when presented through a scheduled bank, would encourage commercial banks to give them facilities for organizing such business. This business would, we consider, be capable of considerable development if the indigenous bankers were to take the scheduled banks more into their confidence by supplying them with information about the composition of their partnerships and submitting to them audited balance sheets. If they take these steps we are sure there will be much greater co-operation between the indigenous bankers and the scheduled banks and through them with the Reserve Bank.

18. Apart from these proposals we would further suggest that those indigenous bankers who would not be eligible for direct Reserve Banking facilities under our scheme might organize themselves on a joint-stock basis into discount companies with membership confined to themselves within a given area. The Reserve Bank would be prepared to discount their paper when presented through such discount houses subject to the usual central banking principles. By this method the indigenous banker would not be required to make so complete a change in his present banking methods. We should be glad to give our careful consideration to any definite proposal on these lines.

Reserve Bank of India,
Central Office,
Calcutta, 26th August 1937.

J. B. TAYLOR,
Governor.

ANNEXURE.

The following conditions should be stipulated for indigenous bankers who wish to be linked directly to the Reserve Bank:—

- (i) They must confine their business to banking proper as defined by the Indian Companies Act. Any other business that they might be conducting should be wound up within a reasonable time.
- (ii) They must maintain proper books of account, and have them audited by registered accountants; the Reserve Bank will have the right to inspect the accounts and call for any information necessary to determine the financial status of the banker.
- (iii) They must file with the Reserve Bank the periodical statements prescribed for scheduled banks. They must also, in the interests of their depositors, publish the returns prescribed for banking companies by the Companies Act and be liable to the same penalties for non-compliance.
- (iv) The Reserve Bank will have the right of regulating the business of the bankers on banking lines, when necessary.
- (v) During a period of five years from the date of their registration as private bankers in the books of the Reserve Bank, they will be entitled to open an account at any of the offices of the Reserve Bank, and be otherwise subject to the same conditions as the scheduled banks except that during such period they will not be required to furnish the compulsory deposits set out in Section 42 of the Reserve Bank Act, unless any of their weekly statements discloses that their time and demand liabilities are five times or more in excess of their capital in the business.

- (vi) If an indigenous banker does not incorporate himself under the Companies Act, his liabilities in respect of his banking commitments will be unlimited. He should therefore state the amount of capital he has available for banking business. (Bankers with a capital of less than two lakhs need not apply).
- (vii) When required they will have to indicate—
 - (a) the names and the extent of interest of their business partners if any; and
 - (b) if any of the bankers is a member of a Hindu joint family, the names and interests of the co-sharers. In both the cases statements will be required from the co-sharers that they are prepared to take their full share in the business and its liabilities.
- (viii) This scheme will be a tentative one for a term of five years, but before the end of this period the Reserve Bank will frame proposals for legislation, if it thinks fit, further to co-ordinate or regulate the position of the private banker. It is likely that such legislation would take the form of a separate Bank Act as suggested by the Banking Enquiry Committee or otherwise to standardise and co-ordinate the status of these registered private bankers on lines in consonance with the scheduled banks.
- (ix) (1) If they satisfy the above conditions, they will have the privilege of rediscount with the Reserve Bank against eligible paper, the right to secure advances against Government paper, and remittance facilities similar to those for the scheduled banks.

(2) If the Reserve Bank decides to take action on the lines here indicated, legislation will be necessary, and the indigenous bankers will then be called upon to make an application in the manner which may then be prescribed.

(3) The Reserve Bank wishes to know whether the members of your association are prepared to be registered as private bankers with it on the above terms. We shall be glad to have their names and capital resources communicated to us as early as possible but not later than the end of September.

APPENDIX B.

Letter dated 24th September 1937 from Chunilal B. Mehta, Esq., President, Bombay Shroff Association, Bombay, to Sir James Taylor, Kt., C.I.E., Governor, Reserve Bank of India, Calcutta.

On behalf of the Committee of our Association, I acknowledge the receipt of the "draft" scheme for the linking of the indigenous bankers with the Reserve Bank of India. The absence of finality and the doubt still indicated in the mind of the Reserve Bank in paragraph 16, detract somewhat from the felicitations, which our Association would have liked to offer to the Reserve Bank authorities on their statesmanlike recognition of the principle, that direct linking of the indigenous bankers with the Reserve Bank is essential and was contemplated by the Indian Central Banking Enquiry Committee as well as by the legislature when they passed the Reserve Bank of India Act. We are particularly glad that you have recognized the necessity of dropping the insistence on legal incorporation of the business of private bankers. Our Association, desiring to see a much quicker realization of the idea, is pained that, three years after the passing of the Reserve Bank of India Act, this matter should still be the subject of enquiry involving search for information, and of doubt. We trust, however, that the scheme now put forward (modified in one or two respects as indicated hereunder) will not be held up any longer, but will be given effect to at the earliest possible moment, and the Reserve Bank authorities will request Government to initiate the necessary legislation therefor in the next session of the Legislative Assembly.

This Association does not agree with some of the views expressed in paragraphs 1, 2 and 3, but they are entirely one with paragraph 4 of your letter. The idea, that commercial joint stock banks are assisting the indigenous banker with a large amount of capital, is wrong. On the contrary, commercial banks have competed with indigenous bankers and have taken away their business. Our Association is, therefore, happy to find that the Reserve Bank has abandoned its original suggestion, viz., that indigenous bankers must come through one or the other of the joint stock banks and would not be linked directly. Equally welcome is the assurance, that the Reserve Bank authorities have no predilection in favour of the joint stock principle, but recognize that the highest class of banking service should be provided by firms of private bankers.

With regard to paragraphs 8 and 9, our Association is agreeable to the provisions of Sections 277(F) and 277(G) being applied to indigenous bankers, but they would not agree to the emphasis, which you are putting, viz., that the principal business should be the taking of deposits. What is provided in these sections is not a definition, but a description, and the description was necessarily taken to describe the working of joint stock banks. The indigenous banking system, which has its points of difference as contrasted with the joint stock banking system, but which, nevertheless, constitutes an important part of the credit system in India, and, as such, has been considered by the Banking Committee and the legislature as fit and eligible for direct relationship with the Reserve Bank of India, would be somewhat unfairly treated, if the Reserve Bank authorities were to take such a description and call upon the indigenous bankers to conform to such description in all respects.

lest there should be any misunderstanding about the position of the indigenous banker, we would like to point

out that the following would be found a little more in the activities of indigenous bankers:—

Buying and selling bills of exchange, hoondies, and drafts, the negotiating of loans and advances; the collecting and transmitting of money; acting as agents for any person or persons, carrying on agency business of any description; financing, or assisting in financing any business; acquiring by purchase or otherwise any property immoveable or moveable; acquiring any rights or privileges which may think necessary or convenient to acquire, or the acquisition of which is likely to facilitate the realisation of any securities held, or to prevent or diminish any apprehended loss or liability; managing, selling and realising all property moveable and immoveable which may come into the possession of in satisfaction or part satisfaction of any of's claims; acquiring and holding and generally dealing with any property and any right, title or interest in any property moveable or immoveable which may form part of the security for any loans or advances, or which may be connected with any such security; doing all such things as are incidental or conducive to the promotion or advancement of the business.

On behalf of my Committee, I should like to mention that there has been hitherto no call and inducement to the indigenous banker to indicate "any general desire to limit and develop his business on the lines suggested by them". No valuable privilege has been held out to the indigenous banker, and no facility has been offered hitherto to make him go out of his way to curtail his activities and to adopt forms of business, which are convenient to the joint stock banks, but which would be somewhat inconvenient to him. Our Association cannot understand why the Reserve Bank authorities desire to make this into a reproach. The indi-

genous bankers have hitherto rightly objected to any revolutionary change in their activities in the absence of a precise statement of the facilities, which would be granted to them. I would like to point out that, banking business as defined above, covers most of their activities as commission agents. It covers all their activities, where they finance the purchase of goods, that are moving in the interior, and, as agents of the parties in the interior, they make the purchase of these goods in the central markets or at the ports. It covers further the activities of the indigenous banker when he gives out a loan for seeds, or for agricultural expenses, including the maintenance of the farmers while the crops are growing, and, when he receives the crops on behalf of the constituent, he deals with the same by selling them in the central market and crediting the amount realised to the account of the debtor. In both these activities it would be noticed that the indigenous banker makes purchases in the central market, or makes sales in the central market, but these transactions are as a rule for and on behalf of his constituents. It is this type of transactions, which predominate, and the indigenous banker charges often to his constituent not merely the interest on the amount engaged, but a commission for services rendered. The indigenous banker in such cases acts as a true banker in the sense, that he assesses the credit of the parties and as a general rule his assessment is sound, as he knows with whom to deal and upto what amount, and how to realise the money back. We trust that it is not the intention of the Reserve Bank authorities to ask the indigenous bankers to shed this part of their business which we maintain, is definitely covered by the quotations given above from Section 277(F) of the Indian Companies Act.

We would go further and say that the Reserve Bank authorities should not ask the indigenous bankers to discard such other family business as they may be carrying on in anticipation and as the result of a prejudice against the banker doing any business. The Reserve Bank must wait,

till it has started dealings with these persons, and till it is demonstrated to the Bank in each individual case, that the continuance of a particular business would entail for the banking business such serious risk as to demand its discontinuance. The only question to decide is what would be called business outside the business of commission agents mentioned above, which it is the desire of the Reserve Bank authorities to segregate, as indicated in paragraphs 10 and 11.

The Shroff Association has already agreed in its previous communication that, indulging in speculative activities should be regarded as a disqualification for direct relationship with the Reserve Bank. On this question the Association is very firm. The point of difference between the Association and the Bank is now narrowed down to the request of this Association, that only speculative business should be excluded and not all business. For example, if an indigenous firm of bankers, besides banking business, is dealing in gold and silver ornaments and silver utensils as merchants, is it seriously suggested by the Reserve Bank authorities that the continuance of such business, after the banker has become linked with the Reserve Bank, would be objectionable? On the contrary, our Association feels that, in some cases the stoppage of ancestral business of the kind illustrated above would involve not only the closing up of a lucrative source of income, but might be a blow to the prestige of the indigenous banker in his locality. I respectfully submit that, on these issues of what is proper and what is not proper so far as the indigenous bankers are concerned, the views of our Association should carry some weight with the Reserve Bank. Our Association would assure them that they are as anxious to see indigenous bankers taking a leading place as bankers in the life of the country, as important as they had once in the past. The difference arises because the Reserve Bank authorities evince too much hesitation and doubt and are laying down

in respect of business other than banking, drastic and impracticable terms.

My Committee does not desire to indulge in any special pleading for the indigenous banker. But the marked hesitation of the Reserve Bank to proceed in the direction of linking them up, induces them to point out that there are about 350 places where there are branches of joint stock banks in India, but there are no less than 2,575 moderate sized townships and 700,000 villages surrounding these townships and having close economic relations with these townships. While the indigenous banker plays some role even in important cities like Bombay and in those townships, where there are branches of joint stock banks, his part in banking and financing at the rest of the places is of the utmost importance. It is not the volume of the transactions in which these bankers figure, but it is the essential service in a place, where there is no other banking service, which they are rendering and which entitles them to the consideration of the Reserve Bank as well as of the legislature of the country.

This Association would be very frank in pointing out in what manner the linking with the Reserve Bank will be useful and will be appreciated. The amount of deposits, which the indigenous bankers were drawing to themselves, have in recent years diminished very much. This has been due to many causes, the principal one being the suction, inducing loanable capital to flow from the interior into the ports and the money centres of India, which was also due in a very large measure to alternatives offered by very high rates, which the joint stock banks began to offer. It would be remembered that in 1931, Government had to borrow and pay on Treasury Bills a rate slightly exceeding 7½ per cent. At the same time Government offered not only in the Post Office savings bank, but in the postal cash certificates a counter attraction, the highest rate of postal

certificates being six per cent free of income-tax. Municipal and other debentures at very heavy rates of interest were also counter-attractions. The deposits with indigenous bankers in old times even took the form of deposits without any interest, as only the safety of the capital was considered. Deposits were kept to oblige the clients and not always with a view to secure working capital. Emergency calls on an indigenous banker were always met by hundies drawn on larger parties generally outside the township. The lending rates of one indigenous banker to another was always there. It was known as the "Sarafi Vyaj". Even when the bank rate was 7 per cent the loans between one indigenous banker and another carried no more than 6 per cent. Current accounts were also carried as between one banker and another carrying a small rate of interest on the balance. There was an infinite variety of practice all over the country in this regard both as between banker and client and as between banker and banker. Whatever the reasons have been in recent times for the weakening of the old system, the linking with the Reserve Bank is expected in our opinion to actually encourage more deposits being drawn towards them. Their working capital would thus increase by this reason and they would look up to the Reserve Bank for emergency capital only, but this good result must necessarily take some years. In the interval we believe, what may be technically called normal finance would also have to be found in some measure for the indigenous bankers. Our Association has no apprehension whatsoever that this course will lead to any difficulties, so far as the Reserve Bank authorities are concerned. It would be open to the Reserve Bank authorities gradually to stiffen the terms, on which they would provide, what they consider normal finance, driving the indigenous bankers more and more to rely on such deposits as they can attract, but our submission is that this should be done gradually. It should be done understandingly, and our Association earnestly requests that these matters should not be handled with a hard and fast code of rules. In this

connection our Association anticipates that, though all the registered bankers would be eligible for loans and advances and discount facilities only some of them would on some occasions make use of finance from the Reserve Bank for normal purposes. Therefore our Association is anxious that the prime benefit of linking with the Reserve Bank should not be destroyed by a strict requirement that, finance from the Reserve Bank should be only used in an emergency.

The result, which the Reserve Bank authorities desire to see at once, viz., the elimination of all other business, would be achieved in due course as the volume of banking business increases. When, after some years, some of the bankers on the register find that their banking business is of sufficient volume to make it attractive for them to shed all other business, they will not need very serious persuasion to do so. Our Association is confident that some of them will even seek to turn themselves into joint stock banks with limited liability, but our Association would earnestly request that there should be no misapprehension with regard to the processes, and the Reserve Bank authorities should not attempt to have in the beginning and at once that desirable goal, which, we all agree, should be reached gradually and by the process indicated above.

Having covered the general ground, and dealt more particularly with clause (i) of the annexure, I will now proceed with some comments on the other clauses.

The requirement in clause (iii) of publishing the returns prescribed for banking companies by the Companies Act, would appear to us to be drastic, so far as the indigenous bankers are concerned. Such a requirement seems to be redundant. In any case, the publication thereof, so that all and sundry may know about this, would do more harm than good. We trust that the Reserve Bank authorities will not insist on this requirement. This does not mean, that all particulars wanted by the Reserve Bank authorities themselves should not be supplied.

With regard to clause (iv), the word "regulating" used therein is not quite clear, and it is requested that the scope of this may be indicated, if convenient.

With regard to clause (vi), our Association appreciates that, indigenous bankers working as firms of private ownership would carry unlimited liability. Though the Reserve Bank authorities do not insist on incorporation, our Association infers that, the Reserve Bank authorities would be glad if some of the indigenous bankers did register themselves as private limited companies. In any event, we read the assurance that, the incorporation by an indigenous banker running his banking business with a capital of not less than Rs. 2 lakhs will not mean any diminution in the status and privileges attached to him as a registered banker.

We have every confidence that, many members of our Association will offer themselves for registration if the scheme modified, as requested by us, is put forward and explained to them. Our Association would, doubtless, place its services at their disposal in connection with this. We may say at once, that, our Association has no particulars of the capital resources of its members, and it would not be proper for us to make a request for this information as, in Indian business, as elsewhere in the world, it is generally considered offensive to put a direct query to a party. Such information would be vouchsafed directly by them to the Reserve Bank as and when they seek registration. Indeed, we think it is somewhat premature to ask for this information, until the necessary amending act, which will enable the scheme to be put into effect, is put on the statute book.

Subject to the few comments made above, we reiterate our felicitations to the Reserve Bank authorities for the progress made in the consideration of this important matter, and trust that, no further time will be lost in giving effect to this scheme.

APPENDIX C.

Letter dated 27th September 1937 from Seth Fatichand Gokaldas, Bankers, Madura, to the Manager, Reserve Bank of India, Madras.

We are in receipt of your letter No.M.No.10504(7)-37 of 22nd instant enclosing a copy of the Draft Scheme for the linking of indigenous bankers with your bank and thank you for the same.

2. It is a matter of deep regret that we Multani bankers who are directly concerned in the matter have not at all been consulted. In Madras Presidency alone there will be more than 100 Multani Bankers, doing business at various places besides a number of Marwari, Gujrati and others. So far as we are concerned, in every place where we have got our firms, there is an association called "The Multani Shroff Association" which is regulating our line of business including the fixing of rates in different localities. Though these associations are not registered, but all Multani bankers are expected to abide by their rules. Even at Madras proper there is the office of our Association whose president is Seth Mangoomal Lunidasing, Bankers, 430 Mint Street, Madras. On enquiry we learn that even this association has not been consulted in the matter. We are therefore of opinion that in case you really want that some of our bankers should have connection with your bank, it is very much necessary that you should have a personal talk with the President of the Madras Association and also invite opinions from other associations.

3. However we give below our personal opinion on the various clauses of the Draft Scheme sent by you.

(i) This may be adopted.

(ii) to (iv) So far as our account books are concerned they have been kept properly and systematically and have to be produced from time to time in Courts of Law and also Income Tax Offices and have never been found fault with. But all our bankers come from Shikarpur a place near Karachi in Sind and therefore all our accounts are kept in our own language viz., Sindhi. As such it will be impossible to have them audited by registered accountants who will not be able to make a head or tail out of these account books, they being unfamiliar with the language. Besides it is highly objectionable to produce our Account Books to the Reserve Bank or any other Bank for the small facility of getting credit for discounting bills with them. It is better to forego the facility than to submit to such unreasonable demands. Our business is based on strict privacy and it will greatly hamper our business if we make up our mind to show our account books. Besides like the Reserve Bank every other blessed bank having dealings with us will call upon us to produce our accounts at any time and the result will be, we will be at the mercy of the scheduled banks. The object underlying the inspection of accounts, appears to be that our deposits should be regulated. In this connection we may point out that we are always averse to taking deposits and have been mainly relying for our resources on our own capital. It is only during season time that we discount our bills with the Scheduled Banks. These Scheduled Banks have been doing business with us for the last number of years and they have good confidence in us knowing well our position and status and also knowing that we do not take deposits from the public at large. As such they have been giving us greater facilities, and have been discounting our bills at the Imperial Bank rate. Now if we change our policy these banks will hesitate to do business with us and therefore in the long run our connection with the Reserve Bank on the lines given by you will

be ruinous. Besides when the Scheduled Banks are taking deposits at interest from 4 to 7 per cent, we feel it will not be worthwhile to do business on borrowed capital, as unlike Scheduled Banks we advance money without any security on a single signature on the personal credit of the party concerned, which is very risky. In case deposits are accepted, we will have to find ways for investment, as otherwise it will be a loss to us. For depositors we will have to keep certain amount of money ready at hand and lose interest thereon, in order to keep up our prestige. If the Reserve Bank wishes to do business with the Indigenous Bankers on the lines of the Imperial Bank and other banks, the step would be most welcome and Multani Bankers will be glad to avail themselves of the facility offered to them, but on the terms and conditions mentioned by you we may assure you no banker with self respect would come to your door to have the facility of discounting bills with you.

Since we are not taking deposits the question of our supplying periodical statements does not arise.

(v) Multani bankers would not like to have compulsory deposits with your bank as required under Section 42 of the Reserve Bank Act.

(vi) No one of our bankers would like to show his real Capital in trade. It is up to your bank to make enquiries about their financial stability as other scheduled banks have been doing.

(vii) This is harmless and may be adopted.

(viii) and (ix). These matters have to be decided by your bank and we have no opinion to offer on them.

In conclusion we may state that banking also is like every other business and when people are doing business with their own capital, it is not understood why the

Reserve Bank should have the entire control over the activities of the Bankers alone. Bankers are indispensable as they have been financing trade and commerce of the country and by adopting strict rules and regulations, you will be driving bankers from banking proper and make them adopt some other business. The result will be that trade and commerce of the country will suffer to a very great extent.

